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SUPREME COURT, U.S.

No. 98-110

In The

Supreme Court of the United States

October Term, 1998

JULIAN P. KORNFELD,

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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SUPPLEMENTAL BRIEF

Pursuant to Rule 15.8 of the Supreme Court Rules, Petitioner respectfully submits this Supplemental Brief in support of his Petition for Certiorari, in order to bring to the attention of the Court the decision of the United States Court of Appeals for the Second Circuit in *Jonathan P. Wolff v. Commissioner of Internal Revenue,* 148 F.3d 186 (hereinafter "*Wolff*")".

SUMMARY OF ARGUMENT

The mere fact that a taxpayer selects a method for a transaction in order to achieve more favorable tax consequences does not justify the imposition of the legal "substance over form" fiction.

ARGUMENT

The *Wolff* case involved the question of whether recognized losses from the cancellation of forward contracts were ordinary losses (as contended by the taxpayer) or capital losses (as contended by the Commissioner).[1]

Forward contracts (a form of commodity futures contracts) could be canceled either by "offset" (which

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[1]Under the law in effect for the years involved, an ordinary loss was fully deductible against income of any nature; whereas a capital loss was only deductible against capital gains and a limited amount of other types of income.

conceedly produced a capital loss) or by "cancellation and termination" which, as argued by the taxpayer, produced an ordinary loss. The mechanics of the "offset" and "cancellation and termination" were different in form as well as substance.

Notwithstanding that at the time of the Tax Court's decision, the United States Court of Appeals for the D.C. Circuit had decided the identical issue in favor of the taxpayer[2] in *Stoller v. Commissioner*, 994 F.2d 855 (D.C. Cir. 1993), amended by 3 F.3rd 1576 (per curium), the Tax Court held for the Commissioner because the "economic result" is the same whether the forward contract is closed by offset or cancellation.

The Second Circuit disagreed, stating:

> "By applying the *Covington* analysis to a contract cancellation, the Tax Court majority would have us impose the legal fiction that, although the contract was canceled, it should nonetheless be treated as if a new offsetting contract was obtained and the two offsetting contracts continued to exist until the settlement date, when delivery of the underlying commodities or securities would be 'deemed' to occur. At that point, the

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[2] The taxpayer in *Stoller* was a member of the very same partnership as the taxpayer in *Wolff*.

> 'sale or exchange' requirement of §1222 would be deemed to have been met under the *Covington* analysis. As Judge Halpern noted in his dissent, this theory 'is not reality; it is a fiction built upon a fiction,' and it is a 'drastic extension of the doctrine of substance over form'." 148 F.3d at 189 (Emphasis supplied)

The Second Circuit further made clear that a taxpayer may choose an alternative method of accomplishing a transaction to obtain more favorable tax consequences stating:

> "Although the economic result achieved by offset or cancellation is identical, both the form and substance of the two closure methods are materially different. The mere fact that Holly [taxpayer] selected the cancellation method in order to achieve more favorable tax consequences does not justify imposition of the legal 'substance over form' fiction. That doctrine applies if the form of a transaction does not accurately reflect its true substance, which is not the case with respect to the Holly contracts." 148 F.3d, at 189 (Emphasis supplied)

Similarly, in the case before this Court, the Tax Court and the Tenth Circuit created a fiction that Julian purchased 100% of certain bonds and then transferred a remainder interest in the bonds to his children and secretary. However, the stipulated facts were that Julian made cash gifts to his two children and secretary; they deposited the cash gifts to their own separate accounts; and then wrote their own separate checks on their own separate bank accounts to Prudential Securities for their remainder interest in the bonds. From an economic standpoint, Julian ends up with a life estate in the bonds and his children and secretary end up with a remainder interest in the bonds. But, the means by which the end result is accomplished are totally different. The Tax Court's and the Tenth Circuit's conclusions that Julian bought 100% of the bonds and gave remainder interests to his children are based upon a total fiction and ignore the stipulated facts in this case.

CONCLUSION

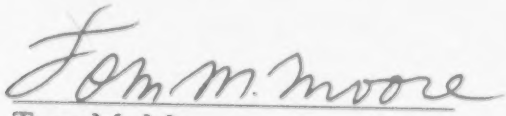
The substance and form of the transaction in this case are the same. This Court should not allow the Tax Court and the Tenth Circuit to create a fiction upon which to create a greater amount of tax for the government. As Judge Halpern stated in his Tax Court dissent:

> "I dissent because I believe that the majority is not justified in disregarding the actual transactions engaged in by Holly (the partnership) in favor of hypothetical transactions that yield the largest tax for the

Government." 108 T.C. 208 (1997), at 232.

Similarly, neither the Tax Court nor Tenth Circuit is justified in disregarding the actual transaction (gifts of cash to donees followed by deposits by donees into their separate bank accounts followed by donees' separate checks written to Prudential Securities for their remainder interests in bonds) in favor of hypothetical transactions (a purchase of 100% of the bonds by Julian followed by a gift of a remainder interest in bonds) that yield the largest tax for the government.

Respectfully submitted,



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